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OFFICE OF THE  
EXECUTIVE SECRETARY

**BEFORE THE TENNESSEE REGULATORY AUTHORITY**  
**NASHVILLE, TENNESSEE**

January 18, 2002

**IN RE:**

**GASCO DISTRIBUTION SYSTEMS, INC.**

**ACTUAL COST ADJUSTMENT (ACA) AUDIT**

)  
)  
) **Docket No. 01-00775**  
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**NOTICE OF FILING BY ENERGY AND WATER DIVISION OF THE TENNESSEE  
REGULATORY AUTHORITY**

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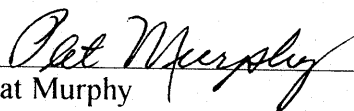
Pursuant to Tenn. Code Ann. §§ 65-4-104, 65-4-111 and 65-3-108, the Energy and Water Division of the Tennessee Regulatory Authority gives notice of its filing of the Gasco Distribution Systems, Inc.'s ACA Audit Report in this docket and would respectfully state as follows:

1. The present docket was opened by the Authority to hear matters arising out of the audit of Gasco Distribution Systems, Inc. (the "Company").
2. The Company's ACA filing was received on August 30 2001, and the Staff completed its audit of same on January 7, 2002.
3. On January 8, 2002, the Energy and Water Division issued its preliminary ACA audit findings to the Company, and on January 10, 2002, the Company responded thereto.
4. The preliminary ACA audit report was modified to reflect the Company's responses and a final ACA audit report (the "Report") resulted therefrom. The Report is attached hereto as Exhibit A and is fully incorporated herein by this reference. The Report

contains the audit findings of the Energy and Water Division, the Company's responses thereto and the recommendations of the Energy and Water Division in connection therewith.

5. The Energy and Water Division hereby files its Report with the Tennessee Regulatory Authority for deposit as a public record and approval of the recommendations and findings contained therein.

Respectfully Submitted:

  
Pat Murphy  
Energy and Water Division of the  
Tennessee Regulatory Authority

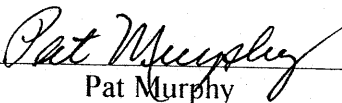
**CERTIFICATE OF SERVICE**

I hereby certify that on this 18th day of January 2002, a true and exact copy of the foregoing has been either hand-delivered or delivered via U.S. Mail, postage pre-paid, to the following persons:

Mr. K. David Waddell  
Executive Secretary  
Tennessee Regulatory Authority  
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Pat Murphy

# EXHIBIT A

COMPLIANCE AUDIT REPORT

OF

**GASCO DISTRIBUTIONS SYSTEMS, INC.**

**ACTUAL COST ADJUSTMENT**

**Docket # 01-00775**

PREPARED BY

**TENNESSEE REGULATORY AUTHORITY**

ENERGY AND WATER DIVISION

JANUARY 2002

COMPLIANCE AUDIT  
**GASCO DISTRIBUTIONS SYSTEMS, INC.**

**ACTUAL COST ADJUSTMENT**

**Docket # 01-00775**

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I. **JURISDICTION AND POWER OF THE TENNESSEE REGULATORY AUTHORITY**

Tennessee Code Annotated (T.C.A.) §65-4-104 gave jurisdiction and control over public utilities to the Tennessee Public Service Commission. By virtue of Chapter 305 of the Public Acts of 1995, jurisdiction and control over public utilities was transferred from the Tennessee Public Service Commission to the Tennessee Regulatory Authority (the "TRA" or "Authority") on July 01, 1996. T.C.A. §65-4-104 states that:

The Authority shall have general supervision and regulation of, jurisdiction, and control over, all public utilities...

T.C.A. states further in §65-4-111 that the public utilities are to maintain a Uniform System of Accounts:

The Authority shall have the power after hearing, upon notice, by order in writing to require every public utility... to keep its books, records, and accounts so as to afford an intelligent understanding of the conduct of its business, and to that end to require every public utility of the same class to adopt a uniform system of accounting. Such system shall conform, where applicable to any system adopted or approved by the Interstate Commerce Commission of the United States. And to furnish annually, or at other times as the Authority may require, a detailed report of finances and operations as shown by said system of accounts.

The TRA responded to T.C.A. §65-4-111 by establishing its own rule 1220-4-1-1.11 regarding the uniform system of accounts which public utilities should maintain. The TRA's rule provides:

The following uniform system of accounting will be followed by utilities and other companies making periodic reports to the Authority:

1. For Classes A and B gas companies - Uniform System of Accounts as adopted by the National Association of Regulatory Utility Commissioners as revised June 30, 1972, and any amendments or revisions pertaining thereto.

The TRA received its authority to examine the books and records of public utilities from T.C.A. §65-4-105 which states that the TRA would possess all the other powers conferred on the TRA. T.C.A. §65-3-108 gives the TRA:

full power to examine the books and papers of the said companies, and to examine, under oath, the officers, agents, and employees of said companies...to procure the necessary information to intelligently and justly discharge their duties and carry out the provisions of this chapter and chapter 5 of this title.

## **II. PURPOSE OF COMPLIANCE AUDITS**

The two basic reasons for compliance audits are to assure compliance with the Uniform System of Accounts (USOA) and to assure that the utility is following all rules, regulations and directives adopted by the TRA.

Compliance audits provide the foundation of assurance underlying the basic objective of regulatory accounting, which is to provide a uniform method of recording transactions among similar companies. This uniform record keeping is accomplished through the adoption of the USOA and insures the integrity, reliability, and comparability of the financial data contained in financial reports filed with the TRA, which provides the TRA with one of its most useful regulatory tools for establishing just and reasonable rates.

## **III. DESCRIPTION OF PURCHASED GAS ADJUSTMENT (PGA) RULE**

The Tennessee Regulatory Authority issued an Order in Docket No. G-86-1, which adopted a new PGA rule beginning July 1, 1992. The PGA Rider is intended to permit the Company to recover, in a timely fashion, the total cost of gas purchased for delivery to its customers and to assure that the Company does not over-collect or under-collect gas costs from its customers. This PGA consists of three major components:

- 1) **The Actual Cost Adjustment (ACA)**
- 2) **The Gas Charge Adjustment (GCA)**
- 3) **The Refund Adjustment (RA)**

The ACA is the difference between the revenues billed customers by means of the GCA and the cost of gas invoiced the Company by suppliers plus margin loss (if allowed by order of the TRA in another docket) as reflected in the Deferred Gas Cost account. The ACA then "true-up" the difference between the actual gas costs and the gas costs recovered from the customer through a surcharge or a refund. The RA refunds the "true-up" along with other supplier refunds.

For a more complete definition of the GCA and RA, please see the PGA Formula in Appendix A.

#### IV. AUDIT TEAM

The TRA's Energy and Water Division is responsible for conducting ACA audits. Pat Murphy of the Energy and Water Division conducted this audit of Gasco Distribution Systems, Inc. ("Gasco" or "Company").

#### V. OBJECTIVE AND SCOPE OF AUDIT

The order for Docket G-86-1 required that the Company

each year...shall file with the Authority an annual report reflecting the transactions in the Deferred Gas Cost Account. Unless the Authority provides written notification to the Company within one hundred eighty (180) days from the date of filing the report, the Deferred Gas Cost Adjustment Account shall be deemed in compliance with the provisions of this Rule...

The objective of this audit was to determine that Purchased Gas Adjustments, which are encompassed by the ACA and were described earlier, approved by the TRA during the period from July 1, 2000, to June 30, 2001, had been calculated correctly and were supported by appropriate source documentation. To accomplish this task, the Staff conducted in-house audit work, during which the Company's calculations of gas costs incurred and gas costs recovered were tested

The Staff also audited a sample of customer bills to determine if the proper PGA rates were being applied in the Company's calculation of the customers' bills. These bills were selected to be representative of the residential, commercial and industrial customers in each of the Company's service areas. The sample was selected from all twelve months of the audit period. After recalculating each sample bill, the Staff is in agreement with the Company's calculation of the customer bills for the period.

The Staff's last ACA audit of Gasco Distribution Systems, Inc. was conducted in 2000 covering the period from July 1, 1999 to June 30, 2000.



VI. **BACKGROUND INFORMATION ON COMPANY AND GAS SUPPLIERS**

Gasco Distribution Systems, Inc., with its office located in Jellico, Tennessee, is a subsidiary of The Titan Energy Group, Inc., which has its headquarters at 4435 East Pike, Zanesville, Ohio. The Company is a gas distributor, which provides service to the City of Jellico (Campbell County), City of Byrdstown (Pickett County) and a few customers in Fentress County, all of which are located in northeast Tennessee. It has approximately 440 customers and an annual sales volume of approximately 61,900 MCF. In addition to Tennessee, Gasco Distributions Systems also operates in Kentucky, Ohio, Pennsylvania, and West Virginia.

The natural gas used to serve this area is provided by GASCO, Inc. (the fuel manager), through long-term contracts with nonaffiliated third parties that deliver gas to the city gate.

## VII. ACA AUDIT FINDINGS

The Company submitted its ACA filing on August 30 2001, covering the period July 1, 2000, to June 30, 2001. The filing reflected a combined **over-collection** of gas costs from Tennessee customers of **\$29,162.03** for the period. Adding a beginning balance of negative \$24,085.77 in over-collected gas costs resulted in an **ending balance at June 30 of negative \$53,247.80.**

The Staff's audit results showed \$37,764.08 in under-collections during the period, resulting in an **ending balance of \$13,678.31 in under-collected gas costs.** Customers will be surcharged this amount during the next twelve months. The difference of **\$66,926.32** between the Company's filing and the Staff's results is the net of the Staff's findings. A list of the exceptions noted in the audit is summarized below.

### SUMMARY OF ACA ACCOUNT:

	Jellico Division	Byrdstown/ Fentress Div.	Combined Filing	Staff Combined	Difference
Beg. Balance	-\$24,084.77	\$ 0	-\$24,084.77	-\$24,084.77	\$ 0
+ Purchases	482,404.37	14,016.45	496,420.82	495,418.13	-1,002.69
- Recoveries	457,208.72	14,726.07	471,934.79	458,588.70	13,349.09
+Interest	-4,712.00	34.99	-4,676.99	933.86	5,610.85
+ Spreadsheet Errors	-50,391.29	-1,419.24	-48,972.05	0	48,972.05
= End. Balance	-\$53,992.41	\$744.61	-\$53,247.80	\$13,678.31	\$66,926.32

### SUMMARY OF FINDINGS (DIFFERENCES):

FINDING #1	ACA factor application	\$13,349.09	Under-collection
FINDING #2	Invoice amount overstated	1,002.69	Over-collection
FINDING #3	Interest on account balance	5,610.85	Under-collection
FINDING #4	Spreadsheet formula errors	<u>48,972.05</u>	Under-collection
	<u>Net Result</u>	<u>\$66,926.32</u>	Under-collection

## **FINDING #1:**

### **Exception**

In its filing, the Company reported incorrect ACA factors for the Byrdstown/Fentress Division.

### **Discussion**

When calculating the amount of the refunds associated with the ACA refund in effect during this period, the Company used the factor  $-\$0.3012$ . However, upon reviewing the Gasco's Billing Registers, we discovered that the Company made no refunds July 2000 through October 2000 for this Division. During November 2000 through March 2001 customers were billed a factor of  $-\$0.5915$  and during April 2001 through June 2001 they were billed a factor of  $-\$0.5017$ . The factors actually used comply with the results of the last audit for Gasco.

This under-statement of the ACA refunds resulted in an **under-collection of \$13,349.09.**

### **Company Response**

The Company is in agreement with the Audit Finding.

**FINDING #2:**

**Exception**

The Company overstated its gas costs for Fentress County for the month of June 2001.

**Discussion**

The Company included an estimated June 2001 invoice for Fentress County. The amount of the actual invoice was \$1,002.69 less than the estimated invoice.

**Company Response**

The Company is in agreement with the Audit Finding.

### **FINDING #3:**

#### **Exception**

The Staff calculated an **under-collection** of interest in the amount of **\$5,610.85**.

#### **Discussion**

The Company continued its practice of using the prime interest rate for the specific month to calculate interest on the balance of the ACA account. The Purchased Gas Adjustment Rule states that the balance in the ACA account "shall be adjusted for interest at the rate provided for the calculation of interest with respect to the Refund Adjustment". The method for calculating the interest on the "Refund due Customers' Account" is described in the Staff's interest rate letter that is sent to all regulated companies on a quarterly basis. The letter states that the average interest rate stated in the letter is the rate to be used for the three months of the quarter. Gasco has been cited for this finding in the last **two** audits. In the most recent audit, the Company responded to the finding by stating: "We used the monthly percentages rather than the quarterly determined by the average of these monthly rates. We don't anticipate any future problems with this computation." Use of incorrect rates led to an **over-collection of interest in the amount of \$385.06**.

In addition, the Staff recalculated the amount of interest on account balance based upon Findings #1, #2, and #4. The calculation produced an **under-collection of interest in the amount of \$5,995.91**.

#### **Company Response**

The Company is in agreement with the Audit Finding.

#### **FINDING #4:**

##### **Exception**

The Company used an incorrect spreadsheet formula to calculate the monthly balances in the ACA account.

##### **Discussion**

Part of the calculation involved in determining the monthly balance in the ACA account is comparing the invoiced gas costs to the gas costs recovered during the month from customer billing. The formula used by the Company was:

Gas Cost Recoveries – Invoiced Gas Costs + ACA Refunds

The correct formula should be:

Invoiced Gas Costs – Gas Cost Recoveries – ACA Refunds

The result of the Company using an incorrect formula to determine the monthly balances was **\$48,972.05 in under-collected gas costs.**

##### **Company Response**

The Company is in agreement with the Audit Finding.

## **VIII. CONCLUSIONS AND RECOMMENDATIONS**

### **Background:**

Staff's last ACA audit of Gasco (Docket No. 00-00998) resulted in an adverse opinion. Specifically, because of the Company's failure to timely implement the ACA refund adjustment as required by the Authority's Rules and directed by its Order of November 24, 1999, the Authority issued an Order requiring Gasco to show cause why it should not be assessed penalties with regard to its non-compliance. The Hearing Officer issued his Initial Order August 24, 2001. The Order stated that the Revised Settlement<sup>1</sup> of the parties was accepted and approved.

Since full compliance with the Authority's rules, directives, and orders is a condition of the Revised Settlement, we are pleased to report that Gasco has demonstrated its compliance to date. Since the August 24, 2001 TRA Order, Gasco has filed two quarterly reports and its ACA filing on time. The Company also paid the remaining installment<sup>2</sup> on its suspended fines, that were ordered due and payable under Dockets 97-00160 and 97-00293 consolidated.

As a result of the last audit, the Company was cited for deficiencies in the following areas:

1. Timely filing of ACA.
2. Application of correct ACA factor to customer bills.
3. Use of incorrect interest rates.

The audit this year reveals that Gasco made its current ACA filing on time. In addition, the correct rates ordered by the Authority were implemented in a timely manner.<sup>3</sup> However, the Company has not corrected its failure to use the interest rates prescribed by the Energy and Water Staff. At the conclusion of the last audit, the Company had indicated that steps would be taken to correct this deficiency, but failed to do so.

### **Audit Conclusions:**

We reviewed the gas costs and recoveries of Gasco Distribution Systems, Inc. for the 12-month period ended June 30, 2001. Based on the Findings noted in Section VII, the net

<sup>1</sup> The terms of the Revised Settlement provide for a \$12,500 penalty against Gasco. \$5,000 is due and payable on or before March 31, 2002, with the remainder to be forgiven only if Gasco complies fully with the TRA's rules, directives and orders for a 3-year probationary period.

<sup>2</sup> \$2,125 was due by December 31, 2001. Payment was received on December 28, 2001.

<sup>3</sup> At the conclusion of the last audit, it was known that Gasco failed to implement the correct ACA refund adjustment for the period July through October 2000. While this finding falls within the current audit period, it was stipulated in the Revised Settlement agreement among the parties that this fact would not trigger another Show Cause proceeding or be evidence of non-compliance as pertains to the terms of the settlement. Staff has chosen not to incorporate this finding into the current audit findings, since it was disclosed in the last audit.

**balance** in the refund due customers account as of June 30, 2001 should be a **positive \$13,678**. This means that as of June 30, the Company had under-collected this amount from its customers. The net balance is composed of an **under-collection from Jellico customers of positive \$15,130** and an **over-collection from Byrdstown/Fentress customers of negative \$1,452**. In order to recover/refund these balances, the correct ACA adjustment factor to be applied to customer bills in the **Jellico Division** is a **positive \$0.2702** (see Attachment 1). The correct ACA adjustment factor to be applied to customer bills in the **Byrdstown/Fentress Division** is a **negative \$0.2966** (see Attachment 2). These factors are to be implemented beginning with the Company's February 2002 billing period and will remain in effect until the Staff's next audit, at which time new factors will be calculated. The Staff's next audit of Gasco will cover the period July 2001 through June 2002.

Overall, the audit process went smoothly. The Company cooperated fully with Staff to provide requested information. Audit findings while material resulted primarily from deficiencies in preparing the filing. Therefore, we conclude that except for the findings noted in this report, the Actual Cost Adjustment component of the Purchased Gas Adjustment ("PGA") Rule is working properly and in accordance with Authority rules.

We would however express to Gasco the importance of reviewing the filing for reasonableness and careless errors prior to filing with the Authority. Case in point is Finding #4. Gasco provided us with an electronic file showing its calculation of the monthly balances in the ACA account. As noted in the summary of Staff's findings (section VII), the error that led to the greatest percent of dollar difference (\$48,972) was a spreadsheet formula error (see discussion in Finding #4). The Company reported in its filing that it had **over-collected \$53,992** from its customers. The Company was not alarmed by this result and did not pre-check the filing for errors. The magnitude of the unreasonable results produced by this formula error went unnoticed by the Company until Staff brought it to their attention. While the reported balance did not represent the true balance, it points to the fact that apparently the Company does not fully understand the true-up process encompassed by the Actual Cost Adjustment.

#### **Audit Recommendations:**

1. The Company should review its spreadsheet formulas to assure accuracy.
2. The Company should review all future filings for reasonableness and mathematical accuracy **prior to** filing with the TRA.
3. The Company should maintain the spreadsheet on a monthly basis. Monitoring the balance on a monthly basis would help alert the Company when a PGA filing was needed.



4. Since Jellico and the Byrdstown/Fentress areas have different sources of gas supply, the Company should submit two separate ACA filings and calculate separate PGA factors for each.<sup>4</sup>
5. The Company should seriously address its failure to use the prescribed interest rates. This has been a finding in three consecutive audits. While the amount of the finding is not material, nevertheless, the method for calculating interest is incorporated into the Purchased Gas Adjustment (PGA) Rule. Staff supplies the rates to all regulated companies, so that there is no question as to the correct rates to use. We do not expect to see this error in the future.

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<sup>4</sup> Gasco recently filed to reduce its Purchased Gas Adjustment by approximately 50% due to declining gas prices.

## APPENDIX A

### PGA FORMULA

The computation of the GCA can be broken down into the following formulas:

$$\text{Firm GCA} = \frac{D + \text{DACA}}{\text{SF}} - \text{DB} + \frac{P + T + \text{SR} + \text{CACA}}{\text{ST}} - \text{CB}$$

$$\text{Non-Firm GCA} = \frac{P + T + \text{SR} + \text{CACA}}{\text{ST}} - \text{CB}$$

where

GCA = The Gas Charge Adjustment in dollars per Ccf/Therm, rounded to no more than five decimal places.

D = The sum of all fixed Gas Costs.

DACA = The demand portion of the ACA.

P = The sum of all commodity/gas charges.

T = The sum of all transportation charges.

SR = The sum of all FERC approved surcharges.

CACA = The commodity portion of the ACA.

DB = The per unit rate of demand costs or other fixed charges included in base rates in the most recently completed general rate case (which may be zero if the Company so elects and the Commission so approves).

CB = The per unit rate of variable gas costs included in base rates in the most recently completed general rate case (which may be zero if the Company so elects and the Commission so approves).

SF = Firm Sales.

ST = Total Sales.

The computation of the RA can be computed using the following formulas:

$$\text{Firm RA} = \frac{\text{DR1} - \text{DR2}}{\text{SFR}} + \frac{\text{CR1} - \text{CR2} + \text{CR3} + i}{\text{STR}}$$

$$\text{Non-Firm RA} = \frac{\text{CR1} - \text{CR2} + \text{CR3} + i}{\text{STR}}$$

where

- RA = The Refund Adjustment in dollars per Ccf/Therm, rounded to no more than five decimal places.
- DR1 = Demand refund not included in a currently effective Refund Adjustment, and received from suppliers by check, wire transfer, or credit memo.
- DR2 = A demand surcharge from a supplier not includable in the GCA, and not included in a currently effective Refund Adjustment.
- CR1 = Commodity refund not included in a currently effective Refund Adjustment, and received from suppliers by check, wire transfer, or credit memo.
- CR2 = A commodity surcharge from a supplier not includable in the GCA, and not included in a currently effective Refund Adjustment.
- CR3 = The residual balance of an expired Refund Adjustment.

- i = Interest on the "Refund Due Customers" account, using the average monthly balances based on the beginning and ending monthly balances. The interest rates for each calendar quarter used to compute such interest shall be the arithmetic mean (to the nearest one-hundredth of one percent) of the prime rate value published in the "Federal Reserve Bulletin" or in the Federal Reserve's "Selected Interest Rates" for the 4th, 3rd, and 2nd months preceding the 1st month of the calendar quarter.
- SFR = Firm sales as defined in the GCA computation, less sales under a transportation or negotiated rate schedule.
- STR = Total sales as defined in the GCA computation, less sales under a transportation or negotiated rate schedule.

# ATTACHMENT 1

## Gasco Distributions Systems, Inc.

### Calculation of the ACA factor (for Jellico customers)

<u>Line No.</u>	Factor to be applied to residential, commercial and industrial customers:		
1	Cost of Gas Purchased (7/99 - 6/00)	198,507.82	
2	Cost of Gas Recovered	<u>208,158.75</u>	
3	Under/(Over) Recovery	(9,650.93)	
4	Interest on Average Monthly Balances	(1,939.37)	
5	ACA Refunds (7/99 - 6/00)	(13,932.76)	
6	Beginning Balance (6/30/99)	<u>(26,427.23)</u>	
7	<b>Balance at 6/30/00</b>	<u><b>(24,084.77)</b></u>	<b>Over Recovery</b>
8	Sales Volumes (Actual 12 month ended 6/30/99)	48,006	MCF
9	ACA Factor (line 7 divided by line 8)	<u><u>(0.5017)</u></u>	Per MCF

# ATTACHMENT 2

## Gasco Distributions Systems, Inc.

### Calculation of the ACA factor (for Byrdstown/Fentress customers)

<u>Line No.</u>	<b>Factor to be applied to residential, commercial and industrial customers:</b>		
1	Cost of Gas Purchased (7/00 - 6/01)	13,013.76	
2	Cost of Gas Recovered	<u>15,392.16</u>	
3	Under/(Over) Recovery	(2,378.40)	
4	Interest on Average Monthly Balances	(36.44)	
5	ACA Refunds (7/00 - 6/01)	(963.19)	
6	Beginning Balance (6/30/99)	<u>-</u>	
7	<b>Balance at 6/30/01</b>	<u><b>(1,451.65)</b></u>	<b>Under-Collection</b>
8	Sales Volumes **	4,895	MCF
9	ACA Factor (line 7 divided by line 8)	<u><u>(0.2966)</u></u>	Per MCF

\*\* Company projected volumes for 12 months ending 6/30/02.